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IN THE

Supreme Court of the United States

October Term, 1981

GEORGE A. CHESTNUTT, JR., WARREN K. GREENE, STANLEY L. SABEL, AMERICAN INVESTORS CORPORATION, and CHESTNUTT CORPORATION,

Petitioners,

v.

ROSALIND FOGEL AND GERALD FOGEL,

Respondents.

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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TABLE OF CONTENTS

PAGE

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

PETITIONERS' REPLY 1

I. The ICA Amendments of 1970, 1975, and 1980 Do Not Support Implication of a Private Right of Action, Under *Curran* or Otherwise 1

A. *The Curran Case* 1

B. *The 1970 Amendments* 2

C. *The 1975 Amendments* 4

D. *The 1980 Amendments* 4

II. The Broad Private Right of Action Recognized Below, Unconstrained by Specific Provisions of the ICA Itself, Will Continue To Plague Mutual Funds and the Federal Courts With Unwarranted Private Damage Actions 6

III. Waiver and Law of the Case Do Not Bar Full Consideration of Whether There Is a Private Right of Action Under the ICA, and This Court Is Free to Hold that Such an Issue Is Jurisdictional 7

TABLE OF AUTHORITIES

Cases	PAGE
Brouk v. Managed Funds, Inc., 286 F.2d 901 (8th Cir. 1961), *vacated as moot*, 369 U.S. 424 (1962)	3, 3 n.3
Burks v. Lasker, 441 U.S. 471 (1979)	3 n.3
Cort v. Ash, 422 U.S. 66 (1975)	5
County of Los Angeles v. Davis, 440 U.S. 625 (1979)	3 n.3
Doyle v. Milton, 73 F. Supp. 281 (S.D.N.Y. 1947)	3
Fogel v. Chestnutt, 668 F.2d 100 (2d Cir. 1981)	7
Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967)	3 n.3
Herm v. Stafford, 663 F.2d 669 (6th Cir. 1981)	5
J. I. Case Co. v. Borak, 377 U.S. 426 (1964)	1
Jackson Transit Authority v. Local Division 1285, 102 S.Ct. 2202 (1982)	9
Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 102 S.Ct. 1825 (1982)	1, 2, 2 n.1, 3, 7, 9
Monheit v. Carter, 376 F. Supp. 334 (S.D.N.Y. 1974)	4
O'Connor v. Donaldson, 422 U.S. 563 (1975)	3 n.3
Rosenfeld v. Black, 445 F.2d 1337 (2d Cir. 1971), *cert. dismissed sub nom. Lazard Freres and Co. v. Rosenfeld*, 409 U.S. 802 (1972)	4, 4 n.4
SEC v. Insurance Securities, Inc., 254 F.2d 642 (9th Cir.), *cert. denied*, 358 U.S. 823 (1958)	4 n.4
Texas & Pacific Railway Co. v. Rigsby, 241 U.S. 33 (1916)	1
Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979)	2 n.1, 5
United States v. Munsingwear, Inc., 340 U.S. 36 (1950)	3 n.3
United States v. Philadelphia National Bank, 374 U.S. 321 (1963)	2 n.1
United States v. Price, 361 U.S. 304 (1960)	2 n.1
United States v. Schooner Peggy, 5 U.S. (1 Cranch) 103 (1801)	7
United States v. Southwestern Cable Co., 392 U.S. 157 (1968)	2 n.1

PAGE

Statutes

Commodity Exchange Act, 7 U.S.C. § 1 et seq. 1, 2, 7
Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 ..... 1, 2
Investment Advisers Act of 1940, Pub. L. No. 76-768, Tit. II, 54 Stat. 789, 15 U.S.C. § 80b-1 et seq. 5
Investment Company Act of 1940, Pub. L. No. 76-768, Tit. I, 54 Stat. 789, 15 U.S.C. § 80a-1 et seq. ..... passim
§ 15(f), 15 U.S.C. § 80a-15(f) 4, 4 n.4
§ 36(a), 15 U.S.C. § 80a-35(a) 3, 4
§ 36(b), 15 U.S.C. § 80a-35(b) 3, 6
Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413 ..... 1, 2, 3, 5
Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97, 164 ..... 1, 2, 4, 5
Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, 94 Stat. 2275 ..... 1, 2, 4, 5

Court Rules

Rule 12(h), Fed. R. Civ. P. 7 n.8, 8

Legislative Materials

REPORTS

H.R. Rep. No. 96-1341, 96th Cong., 2d Sess. (1980) 5 n.5
S. Rep. No. 91-184, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 4897, 4898 3 n.2

HEARINGS

Venture Capital Improvements Acts of 1980: Hearing on H.R. 7554 and H.R. 7491 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 96th Cong., 2d Sess. (1980) 5 n.6

LEGISLATIVE HISTORY

1980 U.S. Code Cong. & Ad. News 4800, 4801-02 5 n.6

Treatises

R. Stern & E. Gressman, *Supreme Court Practice* (5th ed. 1978) 3 n.3

PETITIONERS' REPLY

Respondents defend the erroneous decision below by: (1) incorrectly claiming that the holding that there is an implied private right of action for damages under the Investment Company Act of 1940 ("ICA") may be sustained on the basis of this Court's analysis in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 102 S.Ct. 1825 (1982); (2) attempting to understate the importance of the case at bar by mischaracterizing the scope of the implied rights of action asserted here and in other pending investment company litigation; and (3) exaggerating the procedural aspects of the case to distort beyond recognition our argument that the lower courts are required to apply this Court's new, restrictive approach to every pending case based on an implied private right of action. We discuss each contention in turn, taking first the claim that the *Curran* analysis, if applied to a series of ICA amendments enacted in 1970, 1975, and 1980, supports retrospective liability under the ICA as originally enacted in 1940. The court of appeals rejected respondents' similar argument, and it should fare no better here.

I. The ICA Amendments of 1970, 1975, and 1980 Do Not Support Implication of a Private Right of Action, Under *Curran* or Otherwise.

A. *The Curran Case.* This Court's decision in *Curran* rested on its assessment of the "contemporary legal context" surrounding Congress' comprehensive overhaul in 1974 of federal regulation of commodity futures trading. Two factors were held crucial in concluding that Congress "intended to preserve" the preexisting implied private rights of action that had been supplied by the lower federal courts under the influence of now-disfavored cases such as *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964) and *Texas & Pacific Railway Co. v. Rigsby*, 241 U.S. 33 (1916). First, the Court stressed that the 1974 amendments to the Commodity Exchange Act ("CEA") constituted "a comprehensive reexamination and significant amendment" of the statute. 102 S.Ct. at 1841. Second, the Court emphasized that in 1974 there was an "absence of any dispute about the proposition" that

implied private rights of action were available to enforce the CEA. *Id.* Each factor is an important qualification to the applicability of *Curran* to other federal statutes which are "silent on the subject of [the availability of] private judicial remedies," *id.* at 1833, and respondents have failed to show that either factor is present here.

There is, in addition, an even more fundamental difference between this case and *Curran.* All of the private suits there sustained were premised on the CEA, *as amended* in 1974. *Id.* at 1833-36. In this case, however, respondents have at all times premised their suit solely on the provisions of the ICA as originally enacted in 1940, and most of the conduct complained of and the damages awarded related to periods before the effective dates of any of the various amendments now relied upon by respondents. (A. 43). Even assuming that the 1970, 1975, and 1980 amendments to the ICA reflect an intention to approve implied private damage actions premised on the amended statute -- a point we do not concede -- *Curran* does not support retrospective implication of such rights based on the original version of the ICA.[1]

B. *The 1970 Amendments.* In our view, the 1970 amendments did not make the kind of "substantial changes in the statutory scheme" which served as the predicate for the majority opinion in *Curran. See* 102 S.Ct. at 1833. As reflected in the Senate Report, Congress' changes to the ICA had "three primary objectives": (1) to amend sections pertaining to management fees and sales commissions; (2) to facilitate bank competition with mutual funds; and (3), to add provisions that would "facilitate,

1. The Petition demonstrates that Congress clearly did not intend to create a broad private damage remedy in 1940 (Petn. at 10-15), and respondents fail to show otherwise. This Court has repeatedly held that the views of a later Congress shed very little light upon the proper construction of a statute adopted many years earlier by another Congress, and we do not understand *Curran* to have overruled these cases. *See* Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 22 n.13 (1979); United States v. Southwestern Cable Co., 392 U.S. 157, 170 (1968); United States v. Philadelphia National Bank, 374 U.S. 321, 348-49 (1963); United States v. Price, 361 U.S. 304, 313 (1960).

update, and improve" the administration and enforcement of the ICA.[2] However, the basic structure of the ICA and of the industry it regulates were unchanged. *Cf. Curran, supra,* 102 S.Ct. at 1839.

With respect to whether there was uniformity of judicial decision on the issue of implying private rights of action for damages under the ICA in 1970, we showed in the Petition that this was certainly not the case. At least two decisions, *Doyle* v. *Milton*, 73 F. Supp. 281 (S.D.N.Y. 1947), and *Brouk* v. *Managed Funds, Inc.*, 286 F.2d 901 (8th Cir. 1961), *vacated as moot*, 369 U.S. 424 (1962), had refused to imply broad private rights of action under the ICA. Indeed, *Brouk* was specifically called to the attention of both houses of Congress while the 1970 amendments were under consideration. Petn. at 14 n.20.[3]

Congress' awareness of *Brouk*, and its passage of the limited, prospective private right of action to recover excessive advisory fees in § 36(b) -- accompanied by a specific directive from both houses that the passage of § 36(b) "should not be read by implication to affect subsection (a)" (Petn. at 14 n.20) -- establishes that Congress affirmatively intended, at most, to leave a decidedly

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2. S. Rep. No. 91-184, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 4897, 4898.

3. Respondents have never answered this point, for obvious reasons. The closest they come is to mischaracterize the effect of this Court's decision vacating *Brouk* after the parties settled while the case was pending here on *certiorari*. Br. in Opp. at 9. But this Court commonly vacates cases settled in such circumstances so as to protect the parties from *res judicata* effect thereafter. *See generally* R. Stern & E. Gressman, Supreme Court Practice 897-99 (5th ed. 1978); United States v. Munsingwear, Inc., 340 U.S. 36, 39 (1950). Respondents' citation of O'Connor v. Donaldson, 422 U.S. 563, 577 n.12 (1975), and County of Los Angeles v. Davis, 440 U.S. 625, 634 n.6 (1979), is thus incorrect; both rely on *Munsingwear*, and neither case adopts the broad definition of "precedential effect" espoused by respondents. Br. in Opp. at 9 n.10. Certainly the Eighth Circuit continued to view *Brouk* as a meaningful precedent after the settlement, as did this Court given its citation to that case in Burks v. Lasker, 441 U.S. 471, 476 n.5 (1979). In Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967), the Eighth Circuit actually reaffirmed that *Brouk* still represented the "law" in that Circuit, noting that while *Brouk* placed "this Circuit in the minority" on the issue, plaintiffs' lack of standing meant that "an examination [of that case] is not necessary at this time." *Id.* at 793.

unsettled legal context just as it was. This still unsettled question merits review by this Court, particularly in view of the importance of the ICA to the securities markets.

C. *The 1975 Amendments.* Congress did not significantly amend the ICA when it passed the Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97, 164. Rather, the substance of the change worked in 1975 was to add a new § 15(f) to the ICA, 15 U.S.C. § 80a-15(f), in order to overrule *Rosenfeld v. Black*, 445 F.2d 1337 (2d Cir. 1971), *cert. dismissed sub nom. Lazard Freres and Co.* v. *Rosenfeld*, 409 U.S. 802 (1972), a case which was criticized for imposing undue restraints upon the free transferability of mutual fund interests.[4] The other changes enacted at that time consisted merely of conforming and non-substantive technical amendments.

The non-uniform body of case law with respect to implying private rights of action under the ICA still existed when the 1975 amendments were passed on June 4, 1975. Indeed, in *Monheit v. Carter*, 376 F. Supp. 334, 342 (S.D.N.Y. 1974), Judge Tyler had held that there was no implied private right of action under § 36(a) of the ICA, as amended in 1970. In sum, Congress took no action in 1975 indicating an affirmative intent either to preserve or to create broad, implied private rights of action for damages under the ICA.

D. *The 1980 Amendments.* Similarly, the focus of the Small Business Investment Incentive Act of 1980, Pub.L. No. 96-477, 94 Stat. 2275, was not to overhaul the ICA in any significant way. Congress acted to aid small businesses to raise capital by

4. Contrary to respondents' suggestion, Congress could not have solved the problem created by *Rosenfeld* by "simply eliminating the implied private cause of action" which the Second Circuit had assumed to exist in that case. Br. in Opp. at 23. Rather, § 15(f) was necessary to protect those who act in reliance on that new subsection from SEC enforcement actions such as SEC v. Insurance Securities, Inc., 254 F.2d 642 (9th Cir.), *cert. denied*, 358 U.S. 823 (1958).

alleviating regulatory burdens imposed by the ICA, the Investment Advisers Act, and other federal securities statutes, and the plain language of the 1980 amendments has nothing to do with the issue in this case.[5]

By the time the 1980 amendments were passed, the "contemporary legal context" had, of course, changed dramatically, but not in a way favorable to respondents. This Court's new strict standards for implying private rights of action had evolved in *Cort v. Ash*, 422 U.S. 66 (1975) and subsequent cases, and the state of the law in 1980 was such that Congress could not have relied on the courts to imply private rights of action under the ICA. Moreover, no action was taken to overrule this Court's decision in *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11 (1979), although a predecessor draft of the bill which became the 1980 amendments had included a provision to this effect.[6]

Finally, it is significant that, even following the 1970, 1975, and 1980 amendments to the ICA, the lower courts continue to be skeptical about implying private rights of action under the ICA. In *Herm v. Stafford*, 663 F.2d 669, 685-86 (6th Cir. 1981), the court affirmed dismissal of a private damage action premised on the ICA, expressly disagreeing with the Second Circuit's contrary view because decisions of this Court, notably *Transamerica, supra*, 444 U.S. at 19-20, 22 n.13, had undercut whatever basis there might have been for implying a private cause of action under the ICA.

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5. *See* House Report, H.R. Rep. No. 96-1341, 96th Cong., 2d Sess. 19-20 (1980).

6. See the summary of the legislative history of the 1980 amendments in 1980 U.S. Code Cong. & Ad. News 4800, 4801-02, and references in documents submitted for inclusion in the record, *Venture Capital Improvements Acts of 1980: Hearing on H.R. 7554 and H.R. 7491 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce*, 96th Cong., 2d Sess. 226-39, 240-242 (1980).

II. The Broad Private Right of Action Recognized Below, Unconstrained by Specific Provisions of the ICA Itself, Will Continue To Plague Mutual Funds and the Federal Courts With Unwarranted Private Damage Actions.

Respondents also suggest that several events have reduced this case to one of mere academic interest. Br. in Opp. at 8-9. That is simply not so.

The $4 million judgment affirmed below is based upon the alleged breach of an extremely broad, undefined "fiduciary duty" -- a duty that is neither set forth explicitly in nor constrained by any language of any section of the ICA. *See* Petn. at 8-10. Thus, it is not at all accurate for respondents to suggest (Br. in Opp. at 8-9) that the elimination of the several practices relating to recapture of brokerage commissions somehow renders unimportant the issue of whether such broad, undefined rights of action may properly be implied under the ICA. The recapture episode, which by respondents' admission produced fifty lawsuits including the instant case, illustrates precisely how broad the license to sue created below is. This sweeping federal common law approach -- if allowed to persist -- will continue to plague the federal courts for many years.

Respondents' alternative suggestion that, by adding § 36(b) to the ICA in 1970, Congress meant to grant "mutual fund shareholders an express . . . right of action" equivalent in scope to that asserted here (Br. in Opp. at 9) is also inaccurate. The express private right of action created by § 36(b) is extremely limited in scope, and that section is wholly inapplicable to this case. *See* Petn. at 14. Moreover, the table referred to in the Petition catalogues the large number of pending private actions under the ICA and shows that these cases involve *implied* claims under some fifteen sections or subsections of the ICA other than section 36(b).[7] Accordingly, these cases cannot be sloughed off as § 36(b) cases, and respondents' attempt to do so is, at best, disingenuous.

7. *See* Petn. at 16 n.22; table lodged with the Clerk of this Court.

III. Waiver and Law of the Case Do Not Bar Full Consideration of Whether There Is a Private Right of Action Under the ICA, and This Court Is Free to Hold that Such an Issue Is Jurisdictional.

Respondents' argument that either waiver or the law of the case excused the court below from thorough analysis of the implied right of action issue turns on one fallacious premise: i.e., that the only "change in the law" of sufficient quality, or strength, to invoke the rule of *United States v. Schooner Peggy*, 5 U.S. (1 Cranch) 103 (1801), would have been a decision of this Court, rendered before decision in *Fogel II* below, expressly holding that there was no private right of action under the ICA. Br. in Opp. at 18. That view, although shared -- indeed espoused -- by the court below (A. 15), amounts to a claim that this Court's actions over the past seven years in adopting a "modif[ied] . . . approach to the question whether a federal statute includes a private right of action," *Curran, supra*, 102 S.Ct. at 1838, is not a sufficiently dramatic change in the law to warrant departure from the principles of waiver and law of the case in pending lawsuits involving implication questions, and that this historic change may, with impunity, be ignored in each such case unless and until this Court has specifically addressed the particular statute in question.

The lower federal courts are clearly obligated to apply this fundamental change in the law to every pending case without being compelled to do so, statute by statute, by rulings of this Court. Indeed, we seek no more than what the Sixth Circuit did in *Curran*, where the question of whether an implied right of action existed under the CEA was raised and decided *sua sponte* by the court of appeals in spite of the defendants' failure to raise the issue at all. *See* Petn. at 7.[8]

8. Respondents' exaggerated claim that we seek to abolish the law of the case doctrine is frivolous; it too depends on the incorrect statement that, to receive full consideration below, petitioners were obligated "to demonstrate that this Court has 'positively changed' the law *under the ICA*." Br. in Opp. at 19 (citation omitted, emphasis added). As explained in the text, that formulation of what petitioners had to show to escape application of the law of the case doctrine is far too rigid. Nor is it fair to suggest that the Federal Rules of Civil Procedure preclude the

The Petition also shows that the courts have often characterized the precise question posed in this case -- whether it is appropriate to imply a private right of action under a federal statute -- as "jurisdictional." Petn. at 21-25. In the face of that showing, it is no answer to claim that we ignore a "consistently drawn distinction" between the existence of jurisdiction or of a cause of action. Br. in Opp. at 13-14. There is confusion on the point, and this Court should dispel it.

Nothing prevents this Court from deciding to treat such questions as "jurisdictional," least of all Rule 12(h) of the Federal Rules of Civil Procedure, which we are accused of seeking to "repeal." Br. in Opp. at 16. That Rule merely provides: (1) that a defense of failure to state a claim upon which relief may be granted may be made in certain pleadings, by motion for judgment on the pleadings, "or at the trial on the merits" [Fed. R. Civ. P. 12(h)(2)]; and (2) that the court shall dismiss an action, *sua sponte* or on the suggestion of a party, "[w]henever it appears ... that the court lacks jurisdiction of the subject matter" [Fed. R. Civ. P. 12(h)(3)]. It is left for the courts to define which arguments fall into each category, and the draftsmen of the Rules seemed to regard both jurisdictional and "cause of action" defenses as equally important. As the Notes of the Advisory Committee on the Rules state, with respect to the last amendments to Rule 12(h) in 1966:

> "... the more substantial defenses of failure to state a claim upon which relief can be granted, ... as well as the defense of lack of jurisdiction over the subject matter ..., are expressly preserved against waiver by amended subdivision (h)(2) and (3)."

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result we seek because our position "would invite ... counsel ... to continually attempt to *relitigate* issues which otherwise would have been deemed concluded...." Br. in Opp. at 16 (emphasis added). It is hardly "continual relitigation" to seek -- for the first time in this case -- a reasoned decision as to whether an implied private right of action for damages exists under the ICA, an issue raised as an affirmative defense in the answer. *See* A. 150.

A decision to treat implication issues as jurisdictional gives express recognition to the obvious relation of such questions to fundamental concerns about the very powers of the federal courts. Respondents' claim that *Curran* rejected our argument is frivolous. The defendants there argued that the mere act of implying a private right of action under a federal statute which made no express provision for such suits violated the separation of powers doctrine, *Curran, supra*, 102 S.Ct. at 1838, but petitioners have never made such a claim. When a federal court has fully applied the standards reflected in this Court's recent cases in deciding such an issue, it will only imply a private remedy where it is able to infer that Congress intended such a result. The deference paid to Congress through the application of that analysis preserves the separation of powers. *Curran, supra*, 102 S.Ct. at 1837-38.

But that is not what happened in this case. The court below assumed the existence of an implied right of action without addressing the issue squarely and without applying the legal analysis mandated by this Court's recent decisions. When that happens, the risk is indeed substantial that a right without Congressional sanction or mandate will be enforced by a federal court.[9]

This Court now wisely requires a rigorous search for Congress' own intent before affording private plaintiffs an "implied" right of action under any federal statute, and that requirement is related to separation of powers concerns in an era of increasingly complex federal statutes. *See Curran, supra*, 102 S.Ct. at 1839; *Jackson Transit Authority v. Local Division 1285*, 102 S.Ct. 2202, 2211

9. That risk is obviously magnified, where, as in this case, neither respondents nor the court below identified any statutory source for petitioners' alleged liability. *See* Petn. at 8-10.

(1982) (Powell, J., concurring). The case at bar presents a compelling occasion to insure that all pending cases which present such issues will receive uniform treatment in the lower federal courts.

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